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Federal Communications Commission
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FILE

In the Matter of	)	
	)	
Regulatory Reform for	)	CC Docket No. 92-135
Local Exchange Carriers	)	
Subject to Rate of Return	)	
Regulation	)	

COMMENTS
OF
THE LINCOLN TELEPHONE AND TELEGRAPH COMPANY

The Lincoln Telephone and Telegraph Company ("Lincoln"), by its attorneys, hereby submits its comments in the above-captioned proceeding. In these comments, Lincoln commends the Commission for its proactive stance in this matter and offers some minor modifications to the Commission's tentative proposals. In particular, Lincoln agrees with the Commission's tentative conclusion, in the Notice of Proposed Rulemaking ("NPRM")[1], that the current rate of return process is excessive[2], especially for small and mid-size local exchange carriers ("LEC"). In this regard, Lincoln urges the Commission to develop a regulatory system recognizing the significant differences existing between the larger carriers under price cap regulation and the remaining rate of return LECs.

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1 Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, Notice of Proposed Rulemaking (NPRM), FCC 92-258, Released July 17, 1992.

2 NPRM at para. 42.

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Lincoln also agrees that a continuum of increasingly incentive based plans should be developed.[3] However, these plans should not be used as a mechanism to force LECs into price cap regulation at a later date. Small and mid-size LECs should remain able to elect, on an optional basis, price cap regulation and the regulatory burden it entails.

I. Excessive Regulatory Burden

The current system of regulation was designed primarily for the large LECs, who are now under price cap regulation. An unintentional effect of this system is that a heavy regulatory burden is placed on small and mid-size LECs. The 12 carriers under price cap regulation account for 93% of total industry access lines. Because of the significant differences existing between price cap carriers and the remaining rate of return LECs, it is no longer appropriate to define regulatory requirements based upon a Tier I and Tier II distinction.[4]

Therefore, the Commission should develop a regulatory system that recognizes the differences between price cap and non-price cap carriers. This new regulatory system should include reduction of the regulatory burden by no longer applying filing and reporting requirements designed for the large carriers, now under price cap regulation, to small and mid-size LECs (i.e. ARMIS, Tariff Review Plan, etc.).

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[3] NPRM at para. 3.

[4] The Tier I carriers still under rate of return regulation represent a small portion of the remaining 7% of total industry access lines.

As discussed above, regulatory oversight should no longer be determined by Tier I and Tier II status. The distinction should now be made between price cap and non-price cap carriers. This would be a positive step in reducing the excessive regulatory burden and would not conflict with the Commission's statutory obligations.

II. Optional Incentive Regulation Plan

In the NPRM, the Commission proposes an optional incentive plan that incorporates longer tariff periods, a broader earnings band, greater reliance on historical data, and pricing flexibility. As discussed below, Lincoln generally agrees with these proposals.

A. Frequency of Filings

Lincoln agrees that biennial filings would reduce some of the regulatory burdens and still allow the Commission to fulfill its statutory obligations.[5] Additionally, incentive plan carriers ("IPC") should be allowed to retarget rates to applicable earnings band limits on 14 days notice if, after the first year of a biennial tariff period, earnings are outside of the band. This would result in earnings stability and "ensure that the LEC will remain healthy and able to provide needed services. . ."[6]

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[5] NPRM at para. 10.

[6] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786, 6799 (1990) ("Second Report and Order"), modified on recon., 6 FCC Rcd 2637 (1991), petitions for further recon. dismissed, 6 FCC Rcd 7482 (1991).

Finally, IPCs should retain the option of filing tariff revisions within a tariff period. These mid-course filings should be subject to a reasonable burden of proof. IPCs must still be allowed to make mid-course filings to ensure company viability.

B. Earnings Band

The proposed incentive plan is not significantly less risky to Lincoln than the price cap plan is to the larger carriers. The productivity offset in the price cap plan makes that form of regulation more risky for small and mid-size LECs than for larger carriers. This is because small and mid-size carriers do not have the size nor the economies of scale enjoyed by larger carriers. To derive earnings benefits, IPCs will need to become more productive just as if they were under price cap regulation. However, IPCs need to exceed their own historical productivity levels rather than an industry standard that the Commission has acknowledged may be too great a hurdle for small and mid-size LECs.[7] It should be noted that an IPC's rates are frozen for two years, whereas price cap carriers receive a yearly inflation adjustment. The inclusion of known and measurable items would partially mitigate the risks faced by IPCs, but substantial risk would still exist.

Since the proposed incentive plan is not significantly less risky than price caps, the earnings limit should not be significantly lower. The Commission proposes an earnings band of 100 basis points below and 100 basis points above the authorized

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[7] Second Report and Order.

rate of return.[8] Under this earnings limit proposal, IPCs would have the same underearnings limit as price cap carriers but only one-third of the upper earnings limit. The Commission's proposed earnings band is significantly lower than the price cap band and is not commensurate with the risks that IPCs will face. A fair earnings band would be 100 basis points below and 200 basis points above the authorized rate of return.[9] If optional incentive regulation does not include reasonable earnings incentives, Lincoln and other similarly situated carriers will not elect the plan.

Any sharing mechanism must take into account both overearnings and underearnings. Also, the development of a sharing mechanism must be coupled with an increased earnings band. Any sharing mechanism should be consistent with the sharing mechanism in price cap regulation.

C. Cost Basis for Incentive Plan Tariffs

Initial rates for carriers that elect the optional incentive plan should be filed under 61.38 rules using one year of historical costs and demand. Rates in subsequent biennial filings should be adjusted at the basket level using a cost and demand rate adjustment factor. Rates need to be adjusted at the basket level to avoid the rate shock that would occur if individual rates, adjusted under the pricing flexibility rules, were snapped back to

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[8] NPRM at para. 12.

[9] The expansion of the upper earnings band to 200 basis points would not damage LEC customers because increased earnings, caused by reduced costs, will result in lower rates in the next biennial filing.

Part 69 cost. This type of rate shock would impose undue hardship on IPCs and their customers.

IPCs must be able to include any known and measurable costs or demand not reflected in historical trends. A known and measurable item is any event whose quantity is verifiable and will occur during the biennial tariff period. The inclusion of known and measurable items is essential for earnings stability and to ensure that atypical events are accurately reflected in IPC earnings. In addition, any exogenous adjustments as defined in the price cap rules should be included in IPC rates.

IPCs must always be allowed to target the authorized rate of return, even with the inclusion of known and measurable items. The inability for an IPC to develop rates that are designed to earn the Commission's prescribed rate of return could undermine the legal basis for this incentive plan and make it untenable.

IPCs should keep at least 50% of historical carrier common line minute growth per access line. Lincoln urges the Commission to adopt the USTA proposal in this matter because it would fairly distribute CCL growth among IPCs and their customers.

D. New Services

IPCs should be able to introduce new services on 14 days notice with presumption of lawfulness if the projected yearly earnings will be de minimis. Lincoln agrees with the Commission's definition of de minimis earnings in the NPRM. A new service that does not meet the de minimis test should require a 61.38 cost showing. Any new service introduced during a tariff period should be placed in the appropriate basket at the next biennial filing.

E. Pricing Flexibility

Lincoln agrees with the Commission's proposal to establish common line, traffic sensitive, and special access baskets and to exclude interexchange services from incentive plan regulation.[10] The majority of small and mid-size company interexchange services are under contract. The remaining service revenues are so minor that the cost of regulation would far outweigh the benefits that might be derived and may even preclude some LECs from electing incentive plan regulation.

Lincoln also agrees with the Commission's proposal to allow individual rate elements to be adjusted upward 10% during a biennial tariff period if revenue neutrality is demonstrated at the basket level.[11] Revenue neutrality would be demonstrated at the basket level by multiplying the proposed rates by the historical demand from the last biennial filing and ensuring that these proposed revenues do not exceed the revenues generated by the rates and demand from the last biennial filing. There should be no lower limit on pricing flexibility. The 10% upper pricing limit will prevent predatory pricing and adequately protect consumers. Proposed rates that meet these criteria should be filed on 14 days notice with presumption of lawfulness.

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[10] NPRM at para. 18.

[11] Id.

F. Infrastructure and Service Quality Reporting

IPCs should be required to file service quality reports on a yearly basis and infrastructure reports on a biennial basis. The reports should only contain data that IPCs can reasonably provide. As discussed above, the Commission should not continue to place the same regulatory burden on small and mid-size carriers as placed on the larger price cap carriers.

G. Eligibility and Optionality

Lincoln strongly supports the Commission's tentative position that this plan should be optional.[12] Lincoln also agrees that any LEC electing the incentive plan should remain under it for an entire biennial tariff filing and that a LEC who leaves the incentive plan may not re-elect the plan for four years.[13]

III. Baseline Rate of Return Regulation

LECs remaining under rate of return regulation must continue to have the option of filing tariffs for one year with rates developed using one year of prospective costs and demand. Rate of return regulation is the base from which the continuum of incentive plans is developed and represents a fallback position for LECs unable to meet the productivity demands of the various incentive plans. Therefore, rate of return regulation should not be changed in any way that might hinder a LEC from earning the Commission's prescribed rate of return and attract the necessary capital investment.

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[12] NPRM at para. 23.

[13] Id at para. 26.

Simple extrapolations of costs and demand should no longer be used under rate of return regulation. The Commission, in recent years, has used a simple trend-line analysis to evaluate some rate of return LEC's forecasts. This type of analysis is not appropriate because atypical events, as well as investment in new technologies (i.e. SS7, fiber ring, etc.), will push small and mid-size carriers outside of simple historical extrapolations. These events have a significantly larger impact on small and mid-size LECs than on larger carriers because of their size. Simple historical extrapolations do not fairly compensate small and mid-size LECs and may force significant underearnings. Therefore, rate of return LECs must be allowed to make true prospective filings. No carrier common line adjustment is needed because prospective demand will still be used for ratemaking purposes. New services offered by rate of return LECs should be required to meet the same standard as those offered by IPCs.

IV. Conclusion

In conclusion, Lincoln commends the Commission's recognition that some of the current regulatory processes are excessive and urges that the level of regulatory oversight be determined based on a price cap/non-price cap distinction rather than a Tier I/Tier II distinction. Also, it is important that the Commission recognize the significant risks associated with the optional incentive plan and does not eliminate the incentives by inadequately compensating IPCs for these risks. Finally, the Commission must continue to allow rate of return carriers to file tariffs under the 61.38 rules that exist today. A departure from prospective cost based filings has inherent risks and could harm rate of return LECs.

Respectfully submitted,

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